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SUBJECT: ENERGY DEAL WITH RUSSIA RATIFIED - DEAL OR NO DEAL?

REF: A) Belgrade 929 B) Belgrade 93

SUMMARY

¶1. (U) On September 9 the Serbian Parliament voted 214 to 18 to approve the energy framework agreement with Russia that includes the sale of state oil firm NIS to Gazprom. Ratification of the deal received nearly unanimous support from all sides in the deal. With the framework agreement ratified, the Serbian government will begin negotiations with the Russian government and Gazprom on the details of the sale of NIS. Concurrent with the ratification vote the Serbian government released a Deloitte and Touche report that valued NIS at \$3.1 billion. However, recent public statements from Serbian government officials have focused increasing the capacity of the South Stream pipeline branch through Serbia, rather than the price for NIS. End Summary.

VOTE IN PARLIAMENT DRAWS OVERWHELMING SUPPORT

¶2. (U) As reported in ref A, the Serbian Parliament voted overwhelmingly to ratify the energy framework agreement signed with Russia in January. Four members of the governing coalition from the League of Vojvodina Social Democrats together with members of the opposition LDP and Union of Vojvodina Hungarians (NIS is headquartered in Vojvodina) were the only members to vote against ratifying the agreement in the 214 to 18 vote. With the deal's strong ties to former PM Kostunica's DSS party leadership and the Radical Party (SRS) refocusing on its ties to the East, both DSS and SRS party members supported the agreement.

DEVIL IS IN THE DETAILS

¶3. (SBU) The GOS will now have to negotiate the details of the purchase of state-owned oil firm NIS by Gazprom. Deputy Prime Minister and Economy Minister Dinkic (G-17), who has told us repeatedly that 51% of NIS is worth more than the \$555 million that Gazprom agreed to pay in January, will head the GOS negotiating team. Dinkic opposed the negotiated deal to sell NIS to Gazprom, but he will be limited in how far he can push Russia as the negotiating team also includes the Finance Minister Dragutinovic (DS), Energy Minister Skundric (SPS), and most importantly Foreign Minister Jeremic (DS) and President Tadic's advisor Biserka Jeftimijevic-Drinjakovic. President Tadic stood with then PM Kostunica and then President Putin in Moscow for the agreement signing in January. Tadic is unlikely to allow this agreement to fail as he fears attack from his right for not maintaining a strong relationship with Russia.

¶4. (SBU) At a September 9 press conference Dinkic said that Gazprom should offer a minimum price for NIS based on the fair market value for employees and citizens' shares (referring to the Deloitte valuation of \$3.1 billion for all of NIS). Dinkic said it would also be acceptable if Gazprom agreed to provide additional money to

build infrastructure in Serbia. He added that if NIS was a gift to the Russians then it should be announced publicly that it was a gift. The following day an official from former PM Kostunica's DSS released a press statement that the energy agreement was, in fact, a gift from Russia to Serbia, since Russia was offering to build the South Stream pipeline through Serbia.

RUSSIAN RESPONSE

15. (U) Russian Ambassador to Serbia Konuzin warned in a August 30 letter to leading Serbian daily Politika that delay in ratifying the energy agreement could, "result in a delay and even loss of prospective investment for Serbia." Following the ratification vote Belgrade-based Russian Chamber of Trade and Industry representative Yuri Buligin reportedly told Serbian Chamber of Commerce meeting that the South Stream gas pipeline might not go forward in Serbia as it was a "political issue" and there was a "serious problem in the sector of energy cooperation."

MORE INVESTMENTS OR A BIGGER PIPE?

16. (SBU) Srdjan Mihailovic, advisor to NIS' General Director, told us on September 10 that Dinkic was unlikely to move the Russians from the \$555 million price for NIS. Tadic Advisor Drinjakovic shared the same view, telling us September 12 that she expected negotiations would not drag out and that she would be very surprised if the NIS price changed. Mihailovic said that Dinkic's focus on price is tied to his free shares program that will distribute shares in NIS to Serbian citizens and his desire to have those shares worth as much as possible. He suggested that Dinkic might seek Gazprom agreement to buy shares distributed to NIS employees and Serbian citizens based on \$3.1 billion value. Dinkic could also exclude some of NIS's assets from the sale.

17. (SBU) Dinkic, and later Energy Minister Skundric in an interview with Politika on September 13, focused on seeking an agreement with Russia to enlarge the size of the South Stream gas pipeline branch through Serbia from 10 billion cubic meters (BCM) to 15-18 BCM. Skundric also said that the GOS would press for more specific commitments from Russia to build South Stream across Serbia. This effort to extract a commitment for a larger capacity pipe across Serbia may be an attempt to find something that Tadic can say that Gazprom is giving in exchange for the discounted price the firm offered for NIS.

COMMENT

18. (SBU) The overwhelming support in the Serbian parliament for the energy framework agreement with Russia highlights broad momentum behind the deal. While DPM Dinkic has tried to derail or renegotiate the sale of NIS to Gazprom, he is unlikely to be able to achieve much more than a modest increase in Gazprom's investment commitment or additional vague commitments to build a larger branch of the South Stream pipeline across Serbia. For Gazprom, the size of the South Stream branch, if it is ever built, will be determined by Gazprom's ability to find customers for the gas and not Serbia's desire to have a larger transit pipe. Serbia must also consider the country's almost complete dependence on Gazprom for gas supplies. In the end, President Tadic and FM Jeremic have little stomach to annoy the Russian leadership by reducing the attractive economics of the sale. Even with the NIS sale Russia will still have only limited investments in Serbia. The energy agreement remains an important symbol of Serbia's aspirations to retain economic ties and relationships with both the East and West. End Comment.

MUNTER